

I. Introduction

On January 9, 2008, the Federal Reserve Board (“Board” or “FRB”) published a Proposed Rule restricting certain mortgage practices under the Truth in Lending Act and the Home Ownership Equity Protection Act.¹ Staff of the Federal Trade Commission’s Bureau of Consumer Protection, Bureau of Economics, and Office of Policy Planning (“FTC Staff”) appreciates the opportunity to file this comment on the Proposed Rule.

As the primary federal agency that enforces consumer credit laws with respect to non-depository institutions, the Commission has wide-ranging responsibility regarding consumer financial issues in the mortgage market, including those involving mortgage lenders, brokers, and servicers. The FTC enforces a number of federal laws governing mortgage lending, including the Truth in Lending Act (“TILA”)² and the Home Ownership and Equity Protection Act (“HOEPA”).³ The Commission also enforces Section 5 of the Federal Trade Commission Act (“FTC Act”), which more generally prohibits unfair or deceptive acts and practices in the marketplace.⁴ In addition, the Commission conducts research on mortgage lending and related topics, develops consumer and business education materials,⁵ responds to inquiries about these matters from consumers, industry and the media, and works with other federal and state law enforcement entities to protect consumers from unfair or deceptive mortgage lending and servicing practices.

The FTC staff recognizes that, in the past year, there has been a sharp increase in delinquencies and foreclosures in the mortgage lending market, especially the subprime mortgage market. In 2007, there were an estimated 2.2 million foreclosure filings in the United

¹ Truth In Lending, Proposed Rule, 73 Fed. Reg. 1672 (proposed Jan. 9, 2008), <http://a257.g.akamaitech.net/7/257/2422/01jan20081800/edocket.access.gpo.gov/2008/pdf/E7-25058.pdf>.

² 15 U.S.C. § 1601-1666j (requiring disclosures and establishing other requirements in connection with consumer credit transactions).

³ 15 U.S.C. § 1639 (amending TILA to provide additional protections for consumers who enter into certain high-cost refinance mortgage loans).

⁴ 15 U.S.C. § 45(a).

⁵ Materials on mortgage issues are available at the Commission’s For Consumers Credit web page, at <http://www.ftc.gov/bcp/menus/consumer/credit.shtml>, under the category Mortgages/Real Estate. The web page includes consumer education materials such as “Mortgage Payments Sending You Reeling? Here’s What to Do,” “High-Rate, High-Fee Loans (HOEPA/Section 32 Mortgages),” and “Reverse Mortgages: Get the Facts Before Cashing In On Your Home’s Equity.”

⁶ *A* : *B* : *C* : *A*, 110th Cong. 1 (2008) (Prepared Statement of the Federal Trade

million to consumers. These enforcement actions have targeted deceptive or unfair practices in all stages of mortgage lending – from advertising and marketing through loan servicing – by mortgage lenders, brokers, and loan servicers. The insights from the Commission’s law enforcement experience and research informs the FTC staff’s view of the Proposed Rule.

In most of its mortgage lending cases, the Commission has challenged alleged deception in the advertising or marketing of subprime loans. For example, the FTC’s complaint against a large subprime mortgage lender, Associates First Capital Corporation and Associates Corporation of North America (“The Associates”), alleged that the defendants marketed subprime mortgage loans through false and misleading statements about loan costs.⁸ The Associates represented that consumers would save money when consolidating their existing debts, but these “savings” claims did not take into account the loan fees and closing costs the company typically added to the consumers’ loan amounts. Further, the claims did not reveal that, for certain Associates loans, consumers would pay only interest and would still owe the entire principal amount in a “balloon” payment at the end of the loan term. The complaint also challenged as deceptive the Associates’ practice of including single-premium credit insurance in loans, without disclosing its inclusion to consumers. The defendants paid a record-setting \$215 million in consumer redress to settle the FTC complaint.⁹

⁸ *C.A. v. Associates First Capital Corp., Associates Corp.*, No. 01-00606 (N.D. Ga. 2001).

⁹ *C.A. v. Associates First Capital Corp., Associates Corp.*, No. 01-00606 (N.D. Ga. Sept. 19, 2002) (Order Preliminarily Approving Stipulated Final Judgment and Order). Defendants paid an additional \$25 million to settle a concurrent class action.

¹⁰ Lew Sichelman, *Borrowers Beware: Mortgage Brokers May Be Selling You More Than You Want*, REALTY TIMES, July 18, 2007, http://realtytimes.com/rtcpages/20070718_loseshare.htm; Press Release, Wholesale Access, New Research About Mortgage Brokers Published (July 28, 2005), http://www.wholesaleaccess.com/7_28_mbkr.shtml.

¹¹ *C.C. v. C.C.*, No. 04-549 (C.D. Cal. 2004); *C.D.*, No. 02-5078 (N.D. Ill. 2002). Prepayment penalties on subprime loans are deceptive when originators lead consumers to believe that their loans do not include prepayment penalties when in fact they do. For example, a borrower who holds a 2/28 subprime loan with a 3-year prepayment penalty, and whose creditor has misrepresented that the borrower could refinance without penalty before the loan is recast, has been subject to a deceptive practice in loan marketing.

of the loan.¹² Similarly, the Commission has charged brokers with falsely promising consumers low fixed payments and rates on their mortgage loans.¹³ For example, in June 2004, the Commission sued Chase Financial Funding (“CFF”), a California mortgage broker, and its principals, in connection with sending unsolicited email and direct mail promising a “3.5% fixed payment loan.”¹⁴ The FTC alleged that CFF did not offer any such loan and that the loan CFF falsely advertised was actually a “payment option” adjustable rate mortgage in which interest accrued at a rate higher than advertised, the principal balance would increase if consumers made payments at the advertised rates, and payments were not “fixed.”

In 2006, the Commission filed suit against a mortgage broker for allegedly deceiving Hispanic consumers who sought to refinance their homes by misrepresenting numerous key loan terms.¹⁵ The alleged conduct was egregious because the lender conducted business with his clients almost entirely in Spanish but then provided at closing loan documents in English containing less favorable terms. In a settlement, the court entered a suspended judgment of \$240,000 against the broker, and the broker paid \$10,000 in consumer redress based on a documented inability to pay the full judgment amount. The court also entered a permanent injunction prohibiting the broker from misrepresenting loan terms.¹⁶

Recently, in September 2007, the Commission announced that it was warning mortgage brokers and lenders, and media outlets that carry their advertisements for home mortgages, that some advertising claims may violate federal law.¹⁷ In warning letters, the agency advised over 200 advertisers and media outlets that certain mortgage ads may be deceptive in violation of Section 5 of the FTC Act or may violate the TILA. The ads, including some in Spanish, were identified in June 2007 during a nationwide review focused on claims for very low interest rates or monthly payment amounts without adequate disclosure of other important loan terms. The Commission will continue to monitor the claims made in mortgage advertising and take further action in appropriate cases.

¹² C . D . . . , . . . note 7.

¹³ C . C , . . . note 7; C , . . . note 7; C , . . . note 7.

¹⁴ C . C , . . . note 7.

¹⁵ CC C . . . , . . . note 7.

¹⁶ CC C . . . , No. 06-00019 (E.D. Tex. Sept. 25, 2006) (Stipulated Final Judgment and Order of Permanent Injunction).

¹⁷ Press Release, FTC, FTC Warns Mortgage Advertisers and Media That Ads May Be Deceptive (Sept. 11, 2007), <http://www.ftc.gov/opa/2007/09/mortsurf.shtm>.

¹⁸ *FTC v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003); *FTC v. Fairbanks Capital Corp.*, No. 98-00237 (D.D.C. 1998).

¹⁹ *FTC v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. Nov. 21, 2003) (Order Preliminarily Approving Stipulated Final Judgment and Order as to Fairbanks Capital Corp. and Fairbanks Capital Holding Corp.); *FTC v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. Nov. 21, 2003) (Stipulated Final Judgment and Order as to Thomas D. Basmajian). After the Commission conducted a compliance review of the company in 2007, it filed a joint motion with defendants to modify the 2003 consent order. The order provides substantial benefits to consumers beyond those in the original order, including refunds of fees paid in certain circumstances. *FTC v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. Sept. 6, 2007) (Modified Stipulated Final Judgment and Order).

²¹ See FTC Staff's Mortgage Disclosure Study, note 20.

²² See FTC Staff's Mortgage Broker Compensation Study, note 20.

²⁴ ... , e.g., EDWARD M. GRAMLICH, SUBPRIME MORTGAGES: AMERICA'S LATEST BOOM

credit or the choice of loan products for some subprime borrowers or impose costs or inconveniences upon others. While the FTC staff believes that these restrictions appear to strike a reasonable balance among these considerations, we encourage the Board to continue to use its expertise to weigh the potential benefits and costs of the proposed restrictions and to consider any empirical evidence submitted in response to its Notice of Proposed Rulemaking to confirm that this balance is reasonable.

The FTC staff agrees with the Board that any restrictions adopted should be limited to

³² [REDACTED], GRAMLICH, [REDACTED] note 24, at 6-7, 17-18.

³³ [REDACTED] Statement on Subprime Mortgage Lending, 72 Fed. Reg. at 37,570; GRAMLICH, [REDACTED] note 24, at 6-7, 17-18, 33-35.

³⁴ Truth in Lending, Proposed Rule, 73 Fed. Reg. at 1700-01.

³⁵ [REDACTED], [REDACTED] A [REDACTED] C., No. 05771 EQCE-053090 (Iowa D. Ct. 2006) (Pls. Pet. 5) (cited by Truth in Lending, Proposed Rule, 73 Fed. Reg. at 1701) (alleging, among other things, that Ameriquest improperly influenced and accepted inflated appraisals); [REDACTED] *A* [REDACTED] *b* [REDACTED] : Hearing Before the Subcomm. on Housing, Transportation and Community Development of the S. Comm. on Banking, Housing and Urban Affairs, 110th Cong. 2, 4-7 (2007) (testimony of Alan E. Hummel on behalf of the Appraisal Institute, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, and National Association of Independent Fee Appraisers).

⁴¹ . . . 1713.

⁴² . . . FTC Staff's Mortgage Disclosure Study, . . . note 20.

⁴⁵ Truth in Lending, Proposed Rule, 73 Fed. Reg. at 1698-1700; proposed rule § 226.36(a).

⁴⁶ . 1699-1700.

As noted above, in 2004 the FTC released a Bureau of Economics staff study that used a controlled experiment with over 500 recent mortgage customers to examine how well consumers could understand several variations of a broker compensation disclosure proposed by HUD.⁵⁰ The study found that the compensation disclosures confused consumers, leading many to choose loans that were more expensive than the available alternatives, and created a substantial consumer bias against broker loans, even when the broker loans cost the same or less than direct lender loans.⁵¹ The FTC staff concluded, based on the results of its study, that broker compensation disclosures were likely to harm both consumers and competition in the mortgage market. Subsequent consumer tests of the disclosures conducted by HUD produced similar results.⁵²

A key argument used to support broker compensation disclosures is that many consumers purportedly view mortgage brokers as trusted advisors who shop for the best loan for the consumer.⁵³ But broker compensation disclosures, particularly ones that create consumer confusion, are not the appropriate response to this problem. A better remedy would be to require a disclosure that clarified the role of brokers, alerting consumers to the fact that, just like direct lenders, brokers seek to maximize their own profits and may not provide the least expensive loan for which the consumer qualifies. This less restrictive remedy would address the problem without creating consumer confusion or harming competition. Moreover, consumers would benefit most if such a disclosure were required for all mortgage originators, lenders as well as brokers. Indeed, in the study the Board cites on this issue, 52 percent of older borrowers with lender-originated loans said that they had relied “a lot” on the lender to find the best mortgage for them, which is not strikingly different from the 70 percent with broker-originated loans who

⁵⁰ FTC Staff’s Mortgage Broker Compensation Study, note 20.

⁵¹ For example, in one part of the study, groups of participants were shown different cost disclosures for two identical loans. In the two groups that were shown cost information that did not include a broker compensation disclosure, 95 and 99 percent of the participants correctly recognized that both loans cost the same. However, in the three groups shown cost information that included a broker compensation disclosure for one of the loans, only 49-57 percent of the participants recognized that both loans cost the same. Moreover, 41-50 percent of the participants in the latter groups mistakenly believed that one of the two identical loans was less expensive than the other, with 75-90 percent of these believing that the direct lender loan (which did not disclose compensation) was less expensive than the broker loan (which did disclose compensation). The broker compensation disclosure induced an even stronger bias against the broker loan when participants were asked which loan they would choose if shopping for a mortgage. FTC Staff’s Mortgage Broker Compensation Study, note 20, at ES5-7, 25-27, 29-31.

⁵² HUD’s tests are available at its webpage, Testing HUD’s New Mortgage Disclosure Forms With American Homebuyers (last visited Mar. 14, 2008), <http://www.huduser.org/publications/hsgfin/goodfaith.html>.

⁵³ Truth in Lending, Proposed Rule, 73 Fed. Reg. at 1699.

⁵⁴ Kellie K. Kim Sum & Sharon Hermanson, *Homeownership Gaps: A Review of the Literature*, 83 DATA DIGEST 3 (Jan. 2003) (AARP Public Policy Inst.), http://assets.aarp.org/rgcenter/post-import/dd83_loans.pdf.

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